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TOP SECRET AMERICA

A Washington Post Investigation

Defense mergers on rise

The Pentagon may be planning cutbacks on its outsourcing of work to contractors, but that's not stopped some larger defense contractors from buying up smaller firms that sell specialty services and equipment to the U.S. government's defense and spy agencies.

In recent weeks, major companies have collectively spent about \$1 billion buying firms that specialize in such areas as intelligence analysis, cyber security, unmanned drones, infrared sensors and radio frequency technology -- all areas that are expected to be spared from the Defense Department's budget cuts and consolidation efforts. The buyers and sellers are players in [Top Secret America](#).

Some analysts have called August "M&A fever" because of the number of nationwide mergers and acquisitions, according to a recent article in the [Washington Business Journal](#). Analysts say the acquisitions are a sign that bigger firms have excess cash and are looking for opportunities to expand and grow their revenues. And these days, buying a smaller fish with a specialty is crucial.

"These guys are buying companies that are in the hot lanes of future funding," said Bob Kipps, managing director at KippsDeSanto & Co., a defense and technology-focused investment bank in McLean. "They're looking to reshape their business so they have a greater portion in areas where there's going to be spending over the next decade or more."

"[Defense Secretary Robert Gates] has said 'I'm pruning, thinning out the bureaucracy and layers at the Pentagon and cutting some big-ticket items like airplanes,'" Kipps said. "But there are a handful of areas like cyber security, intelligence gathering and surveillance, and UAVs [unmanned aerial vehicles] where there's certainty that the money is going to go. These firms want to be successful in the years ahead so they're going to where the money is going to be spent."

Here are some of the M&A deals:

*New York-based [L-3 Communications](#), one of the biggest contractors to the Pentagon and a major contractor in Top Secret America, bought [Airborne Technologies Inc.](#) of Ashburn, a company that makes unmanned aircraft systems and does intelligence analysis work for such spy agencies as the [National Reconnaissance Office \(NRO\)](#) and the Defense Advanced Research Projects Agency (DARPA). The financial terms of the deal weren't disclosed. Defense analysts said it gives L-3, which already has a five-year contract worth

up to \$250 million with the U.S. Special Operations Command for its Viking 400 -- a UAV -- a stronger foothold into selling the government unmanned aircraft.

*Flir Systems Inc. of Portland, Ore., which makes infrared sensors and specialty cameras that go on drones or aircraft to collect intelligence information, agreed to pay \$274 million to buy [ICX Technologies](#) in Arlington, which makes a variety of security and intelligence technologies as well as sensors.

*Boeing's made two recent buys, including [Narus](#), a Sunnyvale, Calif., firm that makes anti-cyber attack software, for an undisclosed price, and it paid \$775 million for [Argon ST](#) of Fairfax, a company that makes reconnaissance equipment for planes, sensors and other equipment to help U.S. troops locate snipers.

*[Aecom Technology Corp.](#) of Los Angeles, an engineering and design firm, paid \$355 million for [McNeil Technologies Inc.](#), a Springfield-based company that does intelligence work for defense and spy agencies.

Phil Finnegan, a defense industry analyst at the Teal Group in Fairfax, said he believed that McNeil was likely an attractive buy for Aecom because "intelligence businesses generally have relatively high profit margins and very loyal customers who don't want to keep changing suppliers because they need people with security clearances and they're dealing with sensitive material."

Finnegan said the acquisitions are a reflection that the defense industry "has money to spend."

"There's a desire to invest in areas where they see growth to help shield themselves from the pressure on defense budgets that's in coming years," he said. "Their strategy is to find the niches that are likely to grow and buy them."

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